

Increasingly, standard setting bodies are recognising the need to balance financial integrity against financial inclusion. But how is this best achieved? ask **James Thomas** and **Emmanuel Ioannides**

A man in a dark suit is balancing on a thin, horizontal wire that stretches across the frame. He is leaning forward, with his arms outstretched for balance, and his head tilted back. Below him is a dense urban skyline with numerous skyscrapers under a hazy sky. The overall image conveys a sense of high-stakes balance and risk.

balancing
act

In February 2013, the Financial Action Task Force (FATF) launched its revised Guidance on Anti-money laundering and Terrorist Financing Measures and Financial Inclusion, with the words:

*"applying an overly cautious approach to AML/CFT safeguards can have the unintended consequence of excluding legitimate businesses and consumers from the formal financial system... The Guidance Paper focuses on ensuring that AML/CFT controls do not inhibit access to well regulated financial services for financially excluded and underserved groups"*¹

The FATF Guidance points to the growing emphasis being placed upon financial inclusion considerations by international standard setting bodies. This article outlines the development of the inclusion / integrity debate within policy circles and considers the ongoing challenges of balancing financial inclusion considerations against measures to ensure financial integrity. It also suggests that financial inclusion and financial integrity can increasingly be thought of as complementary rather than contradictory objectives.

Impacts of integrity

Countering the financing of terrorism (CFT) and anti-money laundering (AML) have been significant global priorities for financial sector regulation for some time, aimed at ensuring the integrity of the financial system through safeguarding against illegal activities. However, only more recently have the impacts of AML/CFT measures upon financial inclusion been widely appreciated and acknowledged within policy circles.

Such impacts can be fundamental. For example, "know your customer" (KYC) and customer due diligence (CDD) requirements, introduced under the auspices of AML/CFT, may effectively restrict access to financial services for the very poor, who are typically unable to provide the ID or proof of address that such measures demand in order to open a bank or other type of financial transaction account. KYC requirements have also sometimes proved to be out of step with the rise of new technologies, such as mobile banking, which have the potential to increase poor peoples' access to financial services. Indeed, according to Klaus Prochaska, a Senior Policy Analyst and Knowledge Manager at the Alliance for Financial Inclusion (AFI): "The proportionate application of KYC rules has been one of the biggest bottlenecks and impediments to financial inclusion."

More recently, the trend by some large financial institutions towards "de-risking" has emerged as a significant challenge to financial inclusion. Banks have simply exited jurisdictions which are perceived as having a high money laundering risk, for example through closing their accounts with money services businesses that provide remittance services in those jurisdictions.² The result is that many vulnerable people are left without access to essential remittance streams from developed countries.

In the face of such threats to financial inclusion, the financial inclusion community has been actively engaging with policymakers and standard setting bodies with a view to recalibrating the balance between integrity and inclusion considerations. And it has achieved some success, as Mr Prochaska continues: "There has been a realisation that the existing rules for KYC didn't quite meet the needs of new developments such as mobile banking that held big potential to further financial inclusion. This led institutions such as AFI, CGAP, and the World Bank to pick the topic up and develop it further. However, the first really ground breaking systematic change came in 2010 when the G20 called on global standard setting bodies to consider financial inclusion in their agendas. Since then we have seen a more structured dialogue between the standard setters and the financial inclusion community."

That dialogue is now at an advanced stage, as evidenced by the

recent meeting in Basel convened by Queen Maxima of the Netherlands, the UN Secretary General's Special Advocate for Inclusive Finance for Development, which was attended by the heads of standard setting bodies from the banking, insurance, and payment sectors.³ These bodies have been increasingly engaging with organisations such as AFI and amongst these FATF has perhaps been the most progressive. As Mr Prochaska explains: "FATF has formally responded to the financial inclusion community by putting out some guidance on AML, CFT and financial inclusion. Specifically they also released guidance on the risk based approach. They have taken the issue on and have been constructive." Meanwhile, in response to the trend towards de-risking the UK has created an Action Group on Cross Border Remittances, which is headed by AFI associate and FCA Board Member, Sir Brian Pomeroy.⁴

Examples of best practice

Despite such advances, further steps need to be taken before the objectives of financial integrity and financial inclusion can be fully rationalised. While welcoming FATF's efforts to produce guidance, Mr Prochaska believes that there are potential pitfalls around the implementation of that guidance. "Every country has specific circumstances and when you look at the FATF standards it becomes clear that they have been written for the specific circumstances of developed rather than developing countries," he suggests. "For that reason we have created a Global Standards Subcommittee comprising seven members and a Working Group on Global Standard Proportionality. AFI has members in 94 developing and emerging economies and we are happy to make their experience available, through these groups, to the FATF and other SSBs. For example, we have proposed a structured peer learning between our members and Global Standard Setting Bodies to increase awareness and learning on what the challenges are that developing countries face when they have to translate these standards into national regulation."

As well as reporting on the challenges faced by developing countries, the AFI Working Group is also producing case studies on how successful approaches to balancing financial inclusion and financial integrity have been achieved. It aims to circulate these amongst its membership but also to "trickle them up" to standard setting bodies, thereby enriching the policy debate at a high level.

Amongst these case studies, measures introduced by Mexico could provide a compelling example. As Mr Prochaska explains, Mexico has devised a four-tiered simplified account structure. "Level one" accounts are very low risk accounts with monthly deposit limits of around \$300 and a maximum balance limit of around \$400 dollars. There are no KYC requirements associated with these accounts and clients can open them at any bank branch, banking agent, or over the internet or telephone. "Level two" accounts have higher deposit limits and no maximum balance, as well as some KYC requirements such as the account holder's name, date of birth, address and the state of residence. "Level three" accounts impose slightly higher KYC requirements, alongside higher deposit and balance limits. "Level four" accounts are traditional bank accounts, with the usual KYC requirements.

"Level one accounts are a quasi-anonymous account that can be opened over the phone, which opens up an amazing opportunity to include formerly unbanked people into the financial system," continues Mr Prochaska. "The account works like a prepaid card that is accessible through various channels. The risk that these accounts present to the integrity of the system is very low because nobody uses prepaid cards to launder large amounts of money. However, the deposit and maximum balance limits of such accounts meet the transaction needs of poor people. So Mexico has struck exactly the kind of balance that we want to see: an account regime that is risk based, with low risk and low KYC requirements." >>

According to Mexico's banking and securities regulator, the Comisión Nacional Bancaria y de Valores (CNBV), 7.5m new accounts were created between August 2011 (when the four tier system was introduced) and Sept 2012. This included 4.1m level 1 accounts, 2.3m level two accounts and 0.3m level three accounts.

Into the light

There can be little doubt that the financial inclusion / integrity debate has gathered considerable momentum in recent years, as well as a good deal of consensus over the need for proportionate regulation in order to balance these two important objectives. Indeed, as the FATF Guidelines state:

"FATF encourages FATF members, FSRBs and other FATF observers to promote the guidelines provided in this document in order to make sure that throughout the FATF network, balanced AML/CFT regime [sic] are developed which protect the integrity of the financial system, while at the same time support and facilitate financial inclusion." (p.49 para 148)

Increasingly within this debate there is a willingness to view financial integrity and financial inclusion as complementary rather than incompatible objectives. As Mr Prochaska suggests: "If countries can get this balance right it is a win-win. If you get customers into the financial system, either through bank accounts or e-money accounts accessible over the mobile phone, that means that the transactions that they perform are on the grid. And when you look at financial integrity what you do not want is people being off the grid and completely in the dark. So a good system of financial integrity brings even the small transactions out of the dark and into the light, and aids the poor people as much as the integrity of the system." ■

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1. <http://www.fatf-gafi.org/topics/financialinclusion/documents/revisedguidanceonamlcftandfinancialinclusion.html>
2. <http://www.economist.com/news/middle-east-and-africa/21581995-western-worries-about-money-laundering-are-threatening-economic-lifeline>, see also Maintaining the Flow inCOMPLIANCE Issue 16, Summer 2014, p.26
3. <http://www.fatf-gafi.org/topics/financialinclusion/documents/bcbs-meeting-2-october-2014.html>
4. <https://www.gov.uk/government/policies/helping-developing-countries-economies-to-grow/supporting-pages/enabling-the-continued-flow-of-remittances>



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